



STATE OF VERMONT DEPARTMENT OF TAXES

2003 – 2004
BIENNIAL REPORT

TOM PELHAM, COMMISSIONER

COMMISSIONERS OF TAXES

W.P. Dillingham.....	1882-1888
J.L. Martin.....	1888-1890
P.K. Gleed.....	1890-1892
J.L. Martin.....	1892-1894
D.J. Foster.....	1894-1898
D.H. Lewis.....	1898-1900
J.E. Cushman.....	1900-1913
Charles A. Plumley.....	1913-1919
John M. Avery.....	1919-1920
Melvin G. Morse.....	1920-1921
Fred B. Thomas.....	1921-1925
Paul A. Chase.....	1925-1925
Erwin M. Harvey.....	1925-1945
George H. Amidon.....	1945-1949
Leonard W. Morrison.....	1949-1958
Austin B. Noble.....	1958-1961
Charles T. Shea.....	1961-1965
Gerald S. Witherspoon.....	1965-1969
Lawrence A. Wright.....	1969-1971
Edward Bartlett.....	1971-1972
Robert Lathrop.....	1972-1977
R. Paul Wickes.....	1977-1978
Harriet A. King.....	1978-1981
Elaine K. Hoiska.....	1981-1984
Norris Hoyt.....	1984-1991
Joyce H. Errecart.....	1991-1994
Betsy Anderson.....	1994-1995
Edward W. Haase.....	1996-1998
Sean P. Campbell.....	1999-2000
Janet Ancel.....	2000-2003
Richard Mallary.....	2003-2003
Tom Pelham.....	2003 - Present

OUR MISSION

*TO COLLECT THE PROPER
AMOUNT OF TAX REVENUE
IN A TIMELY AND EFFICIENT
MANNER TO PAY FOR THE
GOODS AND SERVICES PEOPLE
RECEIVE FROM STATE
GOVERNMENT;*

*ADMINISTER BENEFIT
PROGRAMS THROUGH THE
MOST EFFICIENT MEANS
POSSIBLE;*

*SERVE LOCAL GOVERNMENTS
BY STRIVING TO IMPROVE
LOCAL PROPERTY TAX
ASSESSMENT PRACTICES;*

*TO ASSIST AND SERVICE
TAXPAYERS, LEGISLATORS AND
ALL OTHERS BY ANY MEANS
POSSIBLE.*

TO THE GENERAL ASSEMBLY OF THE STATE OF VERMONT

I am pleased to present the Biennial Report of the Commissioner of Taxes for 2003 and 2004, as required by 32 V.S.A. § 3101(b).

The past two years have been busy with making Vermont's tax system fairer, implementing Act 68 and improving the effectiveness of our tax collection systems.

The Department proposed to the legislature and the legislature adopted a number of changes to our tax laws that make our tax system much fairer. Significant among these are adoption of unitary combined reporting for corporate income tax and the closure of a loophole in the bank franchise tax.



TOM PELHAM
COMMISSIONER OF TAXES

These changes will diminish opportunities for certain aggressive tax management strategies that were available to multi-state corporations and will help create a level playing field with respect to Vermont-based corporations.

Also on the fairness front, the Department has created a new Enhanced Tax Compliance Unit. This Unit, comprised of tax examiners, a statistician, and a systems developer are using their combined skills to leverage information available to the Department from a number of sources, including the IRS and Customs officials, for compliance purposes. This new unit will pursue compliance opportunities for its own account, as well as develop and refine compliance opportunities for other units within the Compliance Department. These compliance measures promote tax fairness for taxpayers who consistently meet their Vermont tax obligations relative to the few that do not.

The passage of Act 68 dramatically altered the administration of Vermont's property tax system. The legislature charged the Department with dividing the education grand lists into two segments for the purpose of imposing two tax rates, one for homesteads and the other for all other types of property. With the invaluable support and cooperation of local listers, town clerks and treasurers, Act 68 was implemented successfully and on schedule. The Department won a major victory in *Killington v. Department of Taxes* when the Supreme Court upheld the Department's grand list equalization study, ruling that the Department's procedures were rational and yielded a reasonably reliable result. This is an important case for the State since equalization is essential to equitable funding of education.

The Tax Department is continually looking for ways to be more effective. In the past year we have instituted VTBizFile, a web-based option for sales, meals and rooms and withholding taxpayers to file and pay tax liabilities. We have also reorganized our hearing process for appeals. One staff attorney is now the Department's hearing officer rather than assigning this responsibility to a number of staff throughout the Department. With this change, we have significantly shortened the appeals queue. Looking forward, we have undertaken a program to improve Vermont's rate of e-filing personal income tax returns. We are currently at 27% and have set a goal to be at 50% which would place us well above the national average. E-filing allows the Department to process returns more quickly as well as significantly reducing the cost of processing the return.

Respectfully submitted,

A handwritten signature in black ink that reads "Tom Pelham". The signature is written in a cursive, flowing style.

Tom Pelham
Commissioner of Taxes

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Organizational Chart Key Personnel

DEPARTMENT HIGHLIGHTS

Administration

The Administration section includes the Commissioner, Deputy Commissioner, General Counsel, Policy Analysts, Taxpayer Advocate, Business Manager and their immediate staff- a total of 17 permanent, full-time employees. This section has responsibility for overall management of the Tax Department. The Administrative Division sets Department policy, responds to tax policy inquiries from the Governor and Legislature, issues rulings and technical bulletins to implement tax legislation, directs tax appeal hearings and representation of the Department in appellate, civil and criminal litigation. This Division also provides budget preparation and fiscal management services, personnel administration and payroll processing, procurement of all goods and services (including contract administration) and inventory control for all office supplies, furniture, equipment and tax forms.

Administration is also responsible for all mailroom and stockroom operations, including the preparation and distribution of tax forms, refund checks, delinquency notices, bills and any special mailings to taxpayers. It also coordinates all aspects of the substitute forms program.

Information Systems

Information Systems manages automated information processing for the Department. In this role, the division supports not only the Department, but over 500,000 taxpayers and all the municipalities in the State. The unit is staffed by twenty-three technical positions and one support position. The goal of the division is to provide automated solutions that enable the Department to meet the needs of Vermont taxpayers quickly, effectively and correctly.

During 2003 and 2004, many of the Division's resources were focused on meeting the many legislative mandates resulting from changes to the statewide property tax programs.

Vermont's participation in the Fed/State E-file program has increased each year. This program allows Vermont taxpayers to have both their Federal and State personal income tax returns processed electronically. Direct deposit of refunds is available for electronically filed returns.

In support of our goal to improve web-access for taxpayers, three new online applications were implemented. VTPAY allows taxpayers to pay current income tax payments, estimated tax payments and many delinquent tax liabilities using a credit card. Homestead declarations can be filed online. In late 2004, VTBIZFILE was launched. This application allows business trust tax filers to file and pay their taxes via the web.

The Division continues to support the statewide property tax initiative. It provides support to towns and municipalities using the CAPTAP II software for their listing and tax billing needs.

As we go forward into 2005 and 2006, the resources of the Division will be geared toward the continued development and implementation of the Department's integrated tax system as well as toward the goal of converting additional tax types to that system. The Division will also continue to support towns' efforts to meet legislative mandates that arise on an annual basis. Additionally the Division will be involved in the Department's efforts to expand web based filing options for taxpayers.

Revenue Accounting and Returns Processing (RAARP)

The RAARP section consists of 18 permanent, full-time employees and 36 tax-season temporary employees. This Division is responsible for all revenue accounting and revenue and returns processing for the Department. Those duties include: receiving, opening and routing of all incoming mail; tax return validation and control; data capture via traditional key entry or scanning/imaging; daily bank deposits and related cash management functions including credit card payments and electronic funds transfer, direct deposits, refund management, GAAP/Vision reporting, and bank account/general ledger reconciliation.

In 2003 the division processed 338,931 Personal Income Tax returns; 65,755 of those came through the Fed/State E-file program, a 124% increase over 2002. In 2004, there were approximately 341,356 Personal Income returns processed with 89,599 of them coming through the Fed/State E-file system. We anticipate expanded use of the Fed/State E-file program in 2005.

Property Valuation And Review

The Property Valuation and Review Division (PVR) provides administrative and educational support for Vermont's property tax system. It develops property tax policies and administers several State property tax related programs. Most major functions assigned to the Division involve property taxes and programs that are primarily administered by municipal governments; hence PVR works extensively with local governments in the performance of its duties.

Major programs administered by PVR are detailed below. In addition, the Division frequently performs several other functions such as the appraisal of State owned buildings and land and provides staffing for both Executive and Legislative studies and commissions.

Equalization Study. Annually, the Division conducts a study that results in estimates of the fair market value of all taxable property in all Vermont school districts. The main product of the study is the Equalized Education Grand List (EEGL) which is an estimate of the total fair market value of property that is taxable for school purposes. After determining the EEGL, the school district's common level of appraisal (CLA) is determined by calculating the ratio of the municipality's actual grand list to PVR's EEGL estimate. The CLA is used in the calculation of the school tax rates (Homestead and Nonresidential) that all municipalities are required to assess against individual grand list properties on an annual basis. The Equalization Study is a type of "ratio study". Ratio studies are based on the ratios that result from comparing arm's length sales to the corresponding values found on towns' grand lists. The municipality's grand list is then adjusted to reflect the deviation from fair market value. Sales verification to determine the arm's length status of sales involves considerable input from local appraisal officials but the final determination of validity rests with the Division. The Division has conducted Equalization Studies since the early 1970s. In 1997-8, it undertook an extensive review of the methods and procedures used in the Study including an evaluation by an independent consultant. As a result, extensive changes were implemented beginning with the 1999 Study. The major changes involve improvements in the statistics used in the Study and the review of the results that are aimed at increasing the reliability of the fair market value estimates.

Current Use. Current Use, or the Use Value Appraisal program, allows enrolled property owners with eligible land and buildings to have their property taxes assessed on the productive value of their property, as opposed to its fair market value (which is the legal standard for assessment of real property). Enrolled owners agree to keep this property in productive agricultural and forest use. Owners pay property tax based on separate agricultural and forest productive values. The values are a per acre value and are used uniformly throughout the State in the taxation of enrolled land. Farmers who are enrolled can also have their qualified farm buildings taxed at 0.0% of fair market value. All enrolled property is assessed at its respective use value and this reduction in value is reflected in PVR's equalization study which results in lower education property taxes for affected municipalities. The Division administers a "hold harmless" program that reimburses municipalities for the reduction in municipal taxes resulting from this program. A part of the current use program is the Land Use Change Tax. This is a tax imposed on owners of enrolled land who develop their property or choose to discharge the lien by payment of this tax. The tax is computed at variable rates based on the length of time the property remained enrolled in the Current Use program and it is payable to the State's General Fund.

Vermont Mapping Program. The Vermont Mapping program produces and distributes orthophotographic maps, both analog and digital, for the State. Analog maps exist statewide in two vintages. Digital orthophotography has been completed for all 14 counties. Sales of the digital products have surpassed expectations, underscoring the value of our mapping products. The Mapping Program received funding in the fiscal year 2005 Capital Budget to begin a new round of digital production. The 2005 funds will be used beginning in the spring of 2005 to capture new images of Rutland and Windsor counties. These counties were chosen because their digital images were the oldest, having been produced about 12 years ago. If ongoing funding is forthcoming, the intent is to capture new digital images of the entire State over the next several years. The digital format enhances the accuracy of the product and allows for new uses in concert with evolving technologies. For example, the digital elevation model allows contours to be generated that can be used with property maps and digital orthophotography to create a comprehensive view of property. This enhanced technology allows appraisal officials to more accurately value vacant land from a remote site, thus enhancing both tax equity and operational efficiency. The maps are used heavily by an array of public and private sector organizations to aid in their planning and administrative functions.

Computer Assisted Property Tax Administration Program (CAPTAP). To assist local officials and enhance the standardization of assessment practices within the State, PVR has supported computer software for determining property values and administering the property tax. The Division currently supports a software program called CAPTAP-II. While the use by municipalities of the CAPTAP software is elective, it is the Division's goal to provide an effective software product which municipalities will find advantageous. The Tax Department contracts with selected software developers to produce the programs and provides direct support to municipalities for software use. Currently 185 municipalities use the component of CAPTAP that produces assessment values while 245 municipalities use the tax billing and administration components. The Department also provides direct support services for its CAPTAP products to about 100 municipalities.

DEPARTMENT HIGHLIGHTS - CONTINUED

Property Tax Appeals. PVR fulfills several quasi-judicial functions with regard to property taxation. Appeals of property values as set by municipalities are heard by State Appraisers, who serve as independent hearing officers and set values based on the evidence presented at appeals hearings. The Division provides administrative support to the State Appraisers. Typically the State Appraisers hear more than 150 appeals annually. In addition to property assessment appeals, the Director of PVR hears appeals related to the Current Use program and the results of the Equalization Study.

Technical Support of the Property Tax System. The Division has eight District Advisors who offer direct support to local assessment officials (listers and municipal assessors). The Advisors are regionally located to offer legal and technical advice to listers throughout the State. The expertise available from the Advisors is particularly important as many local officials have a limited background in property assessment and the availability of support both enhances the reliability of assessments and results in greater standardization of assessment practices throughout the State. The Division provides additional support to local officials through a Department attorney and other centrally located staff with expertise in property assessment and property tax administration.

State real estate taxes (Real Estate Withholding, Property Transfer and Lands Gains). Vermont law requires that 2.5 percent of the consideration due to an out-of-state seller of Vermont real property be withheld until the non-resident files a Vermont tax return. The withholding is intended to insure that the appropriate amount of tax on any gain resulting from the transfer is paid. PVR staff also review the income tax returns associated with real estate withholding to determine final tax liabilities relative to the withheld amounts. The Property Transfer Tax is an amount due from a buyer of Vermont real property and is based on a percentage of the sale price. Typically, the tax rate is 1.25 percent of the total sales price. For property that is to be used as a principal residence there is a split rate with .5 percent applied to the first \$100,000 and 1.25 percent applied to the remaining value. Land Gains is a tax imposed on the seller of real property held for a relatively short period and resold. The purpose of the tax is to discourage speculative property transactions by imposing a sliding scale rate on gains that is higher for property held for a shorter term. All three of these taxes have exemptions that reduce or eliminate the tax under statutorily defined circumstances.

Data collection and analysis. PVR has the statutory role of collecting and disseminating information about property taxation in Vermont. The primary data collections include property assessments from all municipalities (the grand lists and the summary of the grand lists) and property tax rates. Beyond this, the Division annually collects information about utility values, locally elected municipal officials and property sales. The Division makes this information available to local officials, State government and the public through its Annual Report. The Division also produces and distributes to municipalities a number of forms that are used in the administration of the property tax.

Payment in Lieu of Taxes (PILOT). State-owned property cannot be taxed by municipalities in Vermont. The PILOT program serves to partially compensate municipalities for the reduction in tax base due to the presence of State-owned buildings and land. PILOT payments are made annually and are based on a calculation that considers the value of State-owned property in a municipality and calculates the taxes that would be paid on those properties if they had been on the tax rolls. This calculation is based on the municipal part of the tax rate (as opposed to school taxes). PVR also values ANR land for payments made to municipalities based on 1% of the land value.

Compliance

Compliance is the enforcement division of the Department of Taxes. The Division continues to utilize technological advances to give us greater capabilities for case selection and collection tracking.

Audit Results for the biennium. The compliance division has 25 tax examiners. Audit assessments include all taxes administered by the Department but the predominant tax types examined were: sales and use, meals and rooms, diesel and gasoline, corporate income tax and individual income tax.

We remain very active in the pursuit of income tax non-filers. In 2003, field and office examination resulted in assessment of a total of \$7.2 million dollars. In 2004, assessment totaled \$15.5 million dollars. Audit cases include assessments, refunds, cases that resulted in no assessment to the taxpayer and examinations of refund requests which often result in the reduction of a refund.

Collection results for the biennium. Approximately 14 full-time positions were devoted to the collection of delinquent taxes, including two field collectors who meet with taxpayers at their places of business. In addition to tax collection, the Department offsets income tax refunds for debts owed to other State agencies and the IRS. About \$2 million dollars is collected each year under the debt offset program and sent to the agencies.

The gross amount of tax accounts receivable is approximately \$80 million dollars. Collection of delinquent taxes is approximately \$30 million per year.

DEPARTMENT HIGHLIGHTS - CONTINUED

Taxpayer Services

The Taxpayer Services Division provides taxpayer assistance by responding to taxpayer questions, assisting in completing tax forms and resolving tax problems for taxpayers, distributing educational materials, encouraging voluntary compliance with Vermont tax laws and examining tax document information. These activities help assure that the Department receives accurate information and the appropriate amount of taxes. The Division also distributes applications for the Lifeline and V-Script programs and processes these applications to verify income.

The Division administers 25 taxes, 7 licensing programs and two benefit programs. The telecommunications tax rate was recently changed to conform to the state sales tax rate and its administration was incorporated into the Division's sales tax administration. The freight line and equipment tax is scheduled for repeal in January of 2006.

In this biennium two significant changes affected the Division. A new education finance plan required splitting the grand list into homestead and non-residential properties. Homestead owners are required to file a form attesting that their property is a homestead. A filed homestead declaration ensures that the property is assessed school property tax by a municipality at the homestead rate. The Division expended much effort educating taxpayers on the importance of filing this form.

The Legislature also enacted unitary combined reporting for corporate income tax during this biennium. While not effective until January of 2006, the Division is determining the changes necessary to implement this major initiative. The Division continues to process Economic Advancement Tax Incentive (EATI) credits as it administers corporate and business income taxes.

We enlarged our telephone call center, already available for use by income taxpayers, to accommodate our withholding, rooms and meals and sales and use taxpayers. The Division responds annually to approximately 155,000 telephone calls. An automated telephone system is also available 24/7 to individual income taxpayers where they can check on the status of their refunds, the status of their homestead declarations, the amount of their prior year education property tax payment and the amount of their estimated income tax payments. Taxpayers may also receive assistance by fax, e-mail, letter or by visiting the office.

The Division provides assistance for businesses through seminars and outreach programs and attends special events such as fairs or craft shows to promote on-site registration. The Division trains volunteer groups such as the Vermont Income Tax Assistance and Tax Counseling for the Elderly (VITA/TCE) that help citizens complete income tax returns. Division staff is also available to assist income taxpayers two days a week from February 1st through April 15th at the IRS in Burlington.

During this biennium, the Division increased its presence on the internet. Taxpayers can now electronically pay by credit card individual income tax estimated payments, current year individual income tax due on a filed return as well as individual income and trust tax bills issued by the Department. A new web site was created at which taxpayers could file the new homestead declaration form. The Division received approximately 41,000 electronically filed homestead declarations. We continue to offer fed/state e-filing to individual income taxpayers with approximately 88,000 taxpayers participating in 2004.

ACTIVE TRUST TAX ACCOUNTS

	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004
<i>Sales and Use Tax</i>			
Monthly	7,600	6,910	7,552
Quarterly	7,337	4,066	5,605
Annual	19,764	20,061	21,467
<i>Meals and Rooms Tax</i>			
Monthly	3,722	3,451	4,213
Quarterly	1,077	619	629
<i>Withholding</i>			
Monthly	3,801	2,474	2,786
Quarterly	23,094	20,485	22,951
Semi-Weekly	1,501	1,587	1,662

RETURNS EXAMINED

	<i>Tax Year 2003</i>	<i>Tax Year 2004</i>
Personal Income Tax	106,885	104,193
Renter Rebate	7,660	6,790
Education Property Tax Payment	38,150	41,923
Homeowner Property Tax Rebate	20,295	21,764
Homestead Declarations		84,159

	<i>Fiscal Year</i>	<i>Fiscal Year</i>
Sales and Use Tax	10,674	36,640 ^a
Meals and Rooms Tax	2,977	8,799
Withholding Tax	16,744	15,609
Corporate/Business Entity Taxes ^{b,c}	36,425	36,479
Estate and Fiduciary Tax ^c	8,267	7,833

During the biennium, the Taxpayer Services Division examined the following volume of tax returns from the worklists. The Division examines many other returns during the year as a result of appeals, large refunds, etc.

^a Increase due to addition of FY2004 multiple returns with payment worklist.

^b Number of accounts.

^c Corporate/Business Entity Taxes and Estate and Fiduciary Tax are not yet on the automated system and are manually reviewed.

INTEREST RATES

<i>Year</i>	<i>Annual Rate</i>	<i>Monthly Rate</i>
1995	7.2	0.6
1996	9.6	0.8
1997	9.6	0.8
1998	9.6	0.8
1999	9.6	0.8
2000	8.4	0.7
2001	9.6	0.8
2002	8.4	0.7
2003	6.0	0.5
2004	6.0	0.5
2005	6.0	0.5

"When a taxpayer fails to pay a tax liability imposed by this title (except the motor vehicle purchase and use tax) on the date prescribed therefor, the commissioner may assess and the taxpayer shall then pay, a sum of interest computed at the rate per annum established by the commissioner pursuant to section 3108 of this title on the unpaid amount of that tax liability for the period from the prescribed date to the date of full payment of the liability." 32 V.S.A. § 3202(a)

REVENUE PER UNIT OF TAX – SELECTED TAXES

<i>Revenue Source</i>	<i>Tax Rate</i>	<i>Yield/Unit of Tax (dollars in millions)</i>
Personal Income	--	NA ¹
Sales & Use ²	6%	\$ 211.1
Meals & Rooms	9%	117.1
Bank Franchise	.0096%	9.9
Gasoline	0.19	66.7
Diesel	0.25	18.1
Purchase and Use	6%	91.0

These simple yield rates assume no change in demand in response to the price change that would accompany a given tax rate change.

Source: Joint Fiscal estimates based on January 2004 Official E-Board Forecast for FY2006.

¹ The personal income tax was restructured in tax year 2002; any estimate of revenue change depends upon bracket, rate and taxable income parameters.

² Includes Telecommunications Tax, which is no longer reported separately.